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No. 430

IN THE SUPREME COURT
OF
THE UNITED STATES

OCTOBER TERM, 1946

UNITED STATES OF AMERICA, Petitioner

vs.

OGILVIE HARDWARE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

This case presents no issue of fact, as the facts were stipulated. It involves the resolution of disputes on several points of law, all directed at determining the meaning of paragraph (a) (3) of Section 501 of the Revenue Act of 1942, which amended paragraph (3) of

Section 26(c) of the Revenue Act of 1936 relating to credits of corporations, to read as follows:

"(3) Deficit corporations. In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

SUMMARY OF THE FACTS

The summary of the facts as set forth in the brief for Petitioner is fair and adequate and, for the purpose only of convenience, we reproduce it here.

> The taxpayer, Ogilvie Hardware Company, Inc., was incorporated under the laws of Louisiana in 1907, with a capital stock of 1,000 shares of common stock of the par value of $100,000 issued and outstanding. It operated a wholesale hardware business in that State on a fiscal year basis, ending on May 31st of each year. (*R. 12-13*).
>
> The surplus of the corporation at the end of the fiscal year ending on May 31st, 1924 was $149,306.43. On July 7, 1924, a one hundred per cent dividend in common stock ($100,000 par value) was issued, share for share, to its common stockholders, which was charged to surplus on the books of the taxpayer during the fiscal year 1925. After charging this dividend to surplus, paying a cash dividend of $14,681, and giving effect to the earnings for the year ending May 31st, 1924, the corporation still had a surplus of $42,229.70. (*R. 13*)
>
> Subsequent to the declaration of the stock dividend, the taxpayer sustained operating losses, and on May 31, 1936, its books disclosed a deficit of $74,875.10. On May 31, 1937, the deficit shown on the books was $71,347.18, and on May 31, 1938 the deficit shown was $60,923.58. (*R.14*)
>
> Upon examination of the taxpayer's income and excess profits returns for the fiscal years ending May 31, 1937 and May 31, 1938, the Commissioner of Internal Revenue made certain adjustments and assessed additional taxes, which were paid by the taxpayer. Of the total taxes paid by the taxpayer

for those periods, $5,426.93 consisted of a surtax on undistributed profits for the fiscal year 1937, and $1,488.86 consisted of a surtax on undistributed profits for the fiscal year 1938. (*R. 15, 16*)

Following the enactment of Section 501 of the Revenue Act of 1942, the taxpayer filed claims for refund of the surtax on undistributed profits in the amounts of $5,426.93 and $1,488.86, for the fiscal years 1937 and 1938, respectively, based on the ground that it had a continuous deficit in accumulated earnings and profits on May 31, 1936, May 31, 1937 and May 31, 1938, which, on each of those dates, exceeded the total amount of its net income for the fiscal years ending with those dates, and that it was thus prohibited by Louisiana law from paying dividends to its stockholders. The Commissioner rejected the claims and thereafter the present suit was instituted to recover these amounts. (*R. 16, 17*)

The district court entered a judgment in favor of the taxpayer for the amount in suit (*R. 27, 28*), and the circuit Court of appeals affirmed (*R. 38*).

SUMMARY OF ARGUMENT

(1) By the 1942 amendment to Section 26(c) of the 1936 Revenue Act, Congress placed on the same footing with regard to liability for surtax on undistributed profits deficit corporations which were forbidden to declare dividends by a state law antedating May 1, 1936, and those which were prohibited from doing so by a written contract antedating May 1, 1936.

This intent on the part of Congress in enacting and on the part of the President in approving this amendment is clear from the plain and unambiguous wording of the statute itself and from the circumstance and the event which brought about the amendment. The circumstance was the obvious injustice to corporations of the class which Congress sought to relieve and the event was the decision of this Court in *Helvering v. Northwest Steel Rolling Mills, 311 U. S. 46*, in which it was held that because of the manner in which the 1936 statute was worded a corporation prohibited by a contract from paying dividends was not penalized and a corporation prohibited by state law from payment of dividends was penalized although other circumstances were identical.

(2) Laws passed by Congress are intended by that body to apply to and to be understood by the people of the United States who speak a common language generally known as the "English" language; and accordingly, unless Congress has specifically indicated a contrary intention, the words used by it in enacting a law should be given their ordinary and common meaning, thus giving effect to the legislative will as expressed in the statute by men who speak the English language and think in terms of that language.

(3) A statute is not open to construction as a matter of course. Where the language of a statute is

plain and unambiguous, as is the case here, the court will not undertake to whittle away or pervert its meaning by construction or interpretation, but will apply the law as it reads to the ascertained facts of a particular case. Words may be tricky things, but they are, in so far as we know, the only medium that has ever been used for the expression of the will of the Legislature by way of a law; and the enactment of a law is the only method by which the legislative will may be made effective. Interpretation of a statute by reference to statements made by committees and individuals prior to its enactment is permissible only when the intent of the Legislature may not be determined from the language of the statute itself.

(4) Where Congress has used the same expression twice in a single paragraph of a law, it will not be presumed that Congress intended to give a different meaning to the expression in one place from what was intended in the other.

(5) A stock dividend lawfully declared in the regular course of business and without intention to avoid or reduce income tax liability converts surplus assets into capital which is no longer available for distribution to stockholders; and where such addition to capital occurred prior to May 1, 1936, it became a part of the capital of the corporation for all purposes, and except in those instances where Congress has specifically otherwise directed it will be considered a part of the corporate capital in relation to income and other Federal taxes.

(6) The opinion of this Court in a particular case should always be read in the light of the facts of that case, and individual statements and expressions of the Court in an opinion may not be plucked out of the content of the opinion as a whole and used as an authority

in another case where the facts are dissimilar and the issues not the same.

(7) Even where an expression in a revenue bill is vague enough to require extrinsic evidence for its proper understanding, the question in such case is not what the Senate intended or what the House of Representatives intended, but what the whole Congress intended. An act of Congress must be passed by both the House and the Senate and must also be approved by the President or passed by a two-thirds vote in both House and Senate over his veto. The report of the Ways and Means Committee of the House on the meaning of a bill is entitled to as much weight as that of the Senate Finance Committee and no more; and a difference of opinion between the two committees as to what they have in mind in recommending tax legislation may not reasonably be resolved by arbitrarily accepting one and ignoring the other.

(8) The Revenue Act of 1936 selected May 1, 1936 as the "good faith" line between contracts prohibiting payments of dividends which were made without relation to the income tax laws and contracts entered into for the purpose of avoiding the surtax on undistributed profits. This same date was kept in mind and used by Congress in amending that portion of the act levying a surtax on undistributed profits of corporations. They first were relieved of the surtax if prohibited by a written contract antedating May 1, 1936 from declaring dividends and were subsequently relieved by the 1942 amendment if prevented from declaring dividends by state law or public regulation antedating May 1, 1936. Where the report of the Ways and Means Committee of the House as to the effect of a section of a revenue act merely gives to the wording of the act its natural significance and where the text of the report of the Senate Finance Committee does the same

thing but in one example given by the Senate Finance Committee another and contradictory meaning is imputed to the section unless it be inferred that the example related to a condition created on or after May 1, 1936, it is proper to give to this example a construction which will harmonize it with the body of the report and with the other examples and with the report of the House Ways and Means Committee on the same section.

(9) A Treasury regulation which conflicts with the act of Congress which it seeks to interpret may not stand, as neither the Constitution nor the laws of the United States have given to any official of the Treasury Department the right to repeal or amend an act of Congress nor to engraft a limitation, a refinement or an unintended meaning upon an act of Congress.

ARGUMENT

We have said that the language used by Congress in enacting Section 501 of the Revenue Act of 1942 is unambiguous. The district judge who heard and studied this case was of this opinion, as were the three judges of the court of appeals. Similarly, the district judge who heard and decided the suit of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, and the three judges of the Court of Appeals for the Sixth Circuit had no occasion to look beyond the statute itself to understand the clear intent of Congress expressed in its enactment.

The decision of the Court of Appeals for the Eighth Circuit in the case of *Century Electric Company v. Commissioner, 144 Fed. (2d) 983*, is authority only for the proposition that where a corporation with a surplus has large current earnings, it cannot convert itself into a deficit corporation by the device of declaring a stock dividend.

The act seemed plain enough to the district judge in the only other case of which we know in which this particular paragraph has been construed and applied. We refer to *Philadelphia Carpet Company v. United States, 68 Fed. Sup. 712.*

This in itself is a pretty fair indication that to plain men interested only in ascertaining the intent and meaning of the statute, it is so worded that it may be understood without extrinsic aid. Of course, the statute itself is the best evidence of its own meaning and that meaning is, we submit, clear enough for anyone who sees it with an unjaundiced eye.

It will be noted from reading Section 501 of the 1942 Revenue Act that it was adopted to retroactively correct the injustice to a large number of corporations

which state laws forbade to declare dividends which injustice became patent after the decision of this Court in *Helvering v. Northwest Steel Rolling Mills*, supra. To the public at large, to members of the House of Representatives, and to members of the Senate, it seemed unfair that relief from the penalty for not distributing current earnings by way of dividends should be extended to corporations prohibited by a contract from making such distribution and denied to corporations which were forbidden to make such distributions by the law of the state or rule of a public regulatory body. Under Section 26(c) (1) of the Revenue Act of 1936, a corporation was entitled to the credit there allowed without regard to its financial status under Federal tax laws; and it has not yet been contended, in so far as we know, that the language of that section should be construed as having a special Federal tax meaning different from that of its ordinary and everyday significance. In order to avoid the penalty for not distributing its current earnings under the 1936 act, a corporation had merely to show that it was precluded by the terms of a valid written contract entered into prior to May 1, 1936 from declaring the dividend. No distinction was drawn by the 1936 act between corporations the capital of which had been derived from original subscriptions only and corporations the capital of which had been in part derived from original subscriptions and in part from the conversion of surplus into capital by the declaration of a stock dividend.

Why, then, should such a distinction be interpolated into the unambiguous language of the 1942 amendment which merely sought to equalize the concessions granted to the corporations prohibited by contract from declaring dividends and those prohibited by a state law?

It has been emphasized in the brief for Petitioner that the court below erred "in holding that the state law is controlling in the determination of whether a corporation is a deficit corporation within the meaning of these provisions of the Federal statute." The statement thus made necessarily assumes a conflict between the state law and the Federal law. In our opinion and in the opinion of the court below, there was no such conflict, as the congressional enactment itself made the state law a part of the test of the right of the taxpayer to claim the surtax exemption.

The exemption is allowed to a deficit corporation if it "is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936." Clearly, the deficit in accumulated earnings and profits referred to by the quoted language is such a deficit as would prevent payment of dividends under a state law in effect prior to May 1, 1936, to which state law one is bound to look both for the prohibition against the payment of dividends and the definition of the conditions under which such prohibition is made effective. If the corporation has a deficit in accumulated earnings and profits as it is defined by the state law and if the state law forbids the payment of dividends during the continuance of the deficit, then the corporation is entitled to the benefit of the exemption. That seems to us to be the meaning of the language which Congress used.

But it is not necessary to go this far in order to justify the construction placed upon the statute by the lower courts. We need take only the common and popular meaning of the words used by Congress—the meaning which is attributed to those words by the

common people of the United States, for whom laws are enacted.

There is no reason for a great pother and stir about the meaning of the term "deficit in accumulated earnings and profits". Certainly "earnings" and "profits" are terms which have general and popular significance and are readily understood by the average man. Those who need enlightenment have but to utilize any one of the standard English dictionaries which are in general use. Similarly, the word "deficit", which is a synonym for "deficiency", is an antonym for "surplus".

A corporation whose operations from a financial standpoint have been such that its outgo has exceeded its income, resulting in a depletion of its capital, is one "having a deficit in accumulated earnings and profits". State laws which provide that dividends may be paid only out of a corporate surplus necessarily prohibit payment of dividends by corporations having a deficit in earnings and profits; for a surplus can be created only out of earnings and profits, and a deficit arises only when the earnings and profits are less than the expenses and the excess of outgo over income must be met by depletion of the capital.

It is urged by the Petitioner that the expressions used by Congress in this section of the 1942 Revenue Act must be taken in a special Federal tax sense and may not be given their ordinary and usual signification. This contention seems to us squarely at odds with accepted canons of construction of statutes by this Court and by courts generally.

In *United States v. Kirby Lumber Company, 284 U. S. 1, 76 L. Ed. 131, 52 S. Ct. 4*, Mr. Justice Holmes, speaking for a unanimous court *in a tax matter*, held that in determining what is gain or profit subject to Federal

income tax, such terms should be given their "plain popular meaning", which is just what the courts below held in this case.

As said by this Court in *United States v. Temple, 15 Otto 97, 26 L. Ed. 967,*

> "Our duty is to read the statute according to the natural and obvious import of the language, without resorting to subtle and forced construction for the purpose of either limiting or extending its operation."[1]

In *Addison v. Holly Hill Fruit Products, 322 U. S. 607, 88 L. Ed. 1488,* this Court said:

> "After all, legislation when not expressed in technical terms is addressed to the common run of men and is, therefore, to be understood according

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Note 1: To the same effect see,

Columbia Water Power Co. v. Columbia Electric Street Railway, etc. Co., 172 U. S. 475, 19 S. Ct. 247, 43 L. Ed. 521;

Southern Railway Co. v. United States, 222 U. S. 20, 32 S. Ct. 2, 56 L. Ed. 72;

United States v. First National Bank, 234 U. S. 245, 34 S. Ct. 846, 58 L. Ed. 1298;

Caminetti v. United States, 242 U. S. 470, 37 S. Ct. 192, 61 L. Ed. 442;

Hammer v. Dagenhart, 247 U. S. 251, 38 S. Ct. 529, 62 L. Ed. 1101;

United States v. Wurts, 303 U. S. 414, 58 S. Ct. 637, 82 L. Ed. 932;

Old Colony Railway Co. v. Commissioner of Internal Revenue, 284 U. S. 552, 52 S. Ct. 211, 76 L. Ed. 484, and authorities cited therein.

to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him."

The general rule is thus stated in *50 Amer. Juris, title "Statutes", Sec. 227:*

> "The only mode in which the will of a legislature is spoken, is in the statute itself. Hence, in the construction of statutes, it is the legislative intent manifested in the statute that is of importance, and such intent must be determined primarily from the language of the statute which affords the best means of its exposition. Indeed, it is the duty of the courts to give a statute the interpretation its language calls for, where this can reasonably be done, and the general rule is that no intent may be imputed to the legislature in the enactment of a law other than such as is supported by the face of the law itself. The courts may not speculate as to the probable intent of the legislature apart from the words. A statute is to be taken, construed, and applied in the form enacted, and so declared, announced, and expounded. Popular demand as to the enforcement of a law adds nothing to, and detracts nothing from, the duty of the court to construe the law as it is. As a reason for these rules, it has been declared that the legislature must be assumed or presumed to know the meaning of words, to have used the words of a statute advisedly, and to have expressed its intent by the use of the words found in the statute."

The emphasis placed throughout the brief for Petitioner upon "the special meaning" which it is claimed the words "earnings" and "profits" and "deficit" have acquired for Federal tax purposes implies that the revenue laws of the United States are not

expressed in language such as the people of the United States in general use but in a tax lingo or dialect which only the initiated—and particularly the people charged with the administration of the revenue laws—can fully understand. We believe that very few congressmen or senators would support this view. Most of them would say that they understand language used in Federal statutes in its natural import and give to it the same meaning as they would give to the same language used elsewhere. So-called "tax experts" pay, we venture to say, only a very tiny percentage of the taxes levied by the United States; and it does not appear reasonable to us to assume that Congress, which is elected by the common people of the United States, would in legislating upon a subject which vitally and immediately affects the wellbeing and the financial status of the great majority of the people of the United States as income taxation does would employ terms which the people who have to pay the tax would not understand unless and until interpreted for them by these tax experts. We are not among those who believe that income tax legislation has a language of its own exclusive and apart from the common understanding of the words which frequently occur in the revenue laws.

We submit on this point that Section 501 of the Revenue Act of 1942 does not require interpretation because it is not ambiguous and because its meaning is clear without interpretation.

Adopting these principles of construction and giving to the words used in Section 501 of the Revenue Act of 1942 their ordinary and common meaning, and applying the statute to the stipulated facts one is, we think, bound to conclude that the judgment of the two lower courts in this case is correct; for that the respondent was in good faith and declared the stock dividend in 1924 in accordance with sound business practices is

not disputed and the stipulation of facts shows that at the end of its fiscal years ending May 31, 1937 and May 31, 1938 the taxpayer had a large deficit; and the Louisiana statute, in unmistakable terms, prohibits payment of dividends by any corporation where the effect of such payment would be the diminution of the capital; and certainly a corporation which has a large deficit instead of a surplus at the end of its fiscal year cannot pay a dividend except out of what is left of its capital.

The Petitioner attempts to avoid this conclusion by separating the capital of the respondent into two parts, one being that which was originally subscribed and the other being the addition to the capital as a result of the stock dividend declared in 1924. As to the latter, the Petitioner assigns to it an amorphous character as both capital and surplus and contends that although for other purposes it was merged into and became a part of the new capital of the corporation, for the purpose of the question involved here it remained a part of the surplus. Petitioner argues accordingly that treating the half of the capital which was added in 1924 not as capital but as surplus has the effect of transforming the respondent from a corporation with a deficit to a corporation with a surplus and thus deprives it of the protection which Congress in the 1924 Revenue Act extended to corporations prohibited by state law from declaring dividends.

The argument thus made is unsound unless hitherto universally accepted principles of the law of corporations be discarded.

In *Fletcher Cyc. Corp., Perm. Ed., Vol. II, Title "Stock and Stockholders", Chap. 5362,* the general rule is thus succinctly stated:

"A stock dividend converts surplus assets into capital."[2]

In *Green v. Bissell*, 79 Conn. 547, 65 Atl. 1056, 8 L. R. A. (N. S.) 1011, the Supreme Court of Connecticut held that,

"The declaration of a stock dividend involves the creation and issue of new shares of stock. The basis of the issue, in so far as payment into the corporation is required of the recipient, is surplus

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Note 2: Among the authorities cited to support the text are,

Equitable Trust Co. v. Prentice, 250 N. Y. 1, 164 N. E. 733;
Harding v. Staples, 111 Ken. 325, 140 Atl. 846;
Green v. Bissell, 79 Conn. 547, 65 Atl. 1056, 8 L. R. A. (N. S.) 1011; 118 Am. St. Rep. 156, 9 Ann. Cas. 287;
Bryan v. Aikin, 10 Del. Ch. 1, 82 Atl. 817;
In re Joy's Estate, 247 Mich. 418, 225 N. W. 878;
Lamb v. Lehmann, 110 Ohio St. 59, 143 N. E. 276;
In re Estate of Heaton, 89 Vt. 550, 96 Atl. 21, L. R. A. 1916A 201;

to which list we add,

Eisner v. Macomber, 252 U. S. 189, 64 L. Ed. 521;
Commissioner v. Cordingley, 78 Fed. (2d) 118 (1st cir.);
Petty v. Helvering, 98 Fed. (2d) 717, (2nd cir.);
Commissioner v. Champion, 78 Fed. (2d) 513 (6th cir.);
Commissioner v. Quackenbos, 78 Fed. (2d) 156 (2nd cir.);
Commissioner v. Ahlborn, et al., 77 Fed. (2d) 700 (3rd cir.).

assets which thus become converted into strict capital with all which that implies.";

and in *Lamb v. Lehmann, 110 Ohio St. 59, 143 N. E. 276,* the Supreme Court of Ohio said,

> "A declaration of a so-called stock dividend has no other effect, so far as the corporation itself is concerned, than to carry the position of the surplus covered by such stock dividend into the permanent capital account, thereby placing it beyond the power of the Board of Directors to withdraw it from corporate use and distribute to stockholders.";

and in *In re Estate of Heaton, 89 Vt. 550, 96 Atl. 21, L. R. A. 1916A 201,* the Supreme Court of Vermont declared that,

> "Such a dividend operates to transfer distributable assets to the individual ownership of the stockholders, thus changing accumulated surplus into permanent capital, and thereby creating an additional liability of the corporation."

In *Eisner v. Macomber, 252 U. S. 189, 64 L. Ed. 521,* this Court said:

> "A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. *Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer as available for actual distribution.*" (*Emphasis ours.*)

All of the cases which we have cited on this point hold the same way; so there is nothing to be gained by

piling quotation on quotation to prove that when the respondent transferred $100,000 from its surplus to its capital account in 1924 by declaring a stock dividend, its capital thereafter was $200,000 whereas before it had been $100,000; and this $200,000 was its capital for all purposes—not merely for some. This stock dividend was declared by the respondent many years before Congress levied a tax upon undistributed profits. It was a corporate act done in good faith for a strictly business purpose and had no relation to the avoidance or reduction of Federal income taxes. There is, it seems to us, no logical basis for the attempted distinction between the capital originally subscribed and the addition made to it in 1924.

In the case of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, in which the same contention was advanced that is here made, the Court of Appeals for the Sixth Circuit in a powerfully reasoned decision thus rejected the contention:

> "The Commissioner's contention is based upon the ground that the taxpayer's deficit was the result of the $130,000 non-taxable stock dividend declared in 1929. It is argued that, since non-taxable stock dividends do not affect or diminish earnings and profits, they, therefore, cannot cause a deficit, and that there was in this case, therefore, no deficit in the taxpayer's accumulated earnings or profits. * * * * * *"

The court then refers to the argument of the Commissioner that,

> "Because the foregoing section provides that a stock dividend, like that in this case, shall not be considered a distribution of earnings or profits, it is urged that such a dividend cannot cause a deficit in

earnings and profits, and that, consequently, a corporation whose deficit on its books results from a distribution of tax-free stock dividends may not, within the meaning of the statute, have the benefit of the credit granted by Section 501 of the Revenue Act of 1942."

Then the court pointed out what the Commissioner had overlooked; and what it said is just as applicable to this case as to the case before it.

"Appellee does not claim that the distribution of the stock dividends was a distribution of the company's earnings and profits. On the contrary, it is maintained that there never was any such distribution, but rather that the earnings and profits were capitalized by the act of the corporation in transferring them to its capital account and were no longer available for distribution to stockholders. It is submitted by appellee that by the action of the corporation, the earnings and profits became, as of the time of the declaration of the dividend, merged and coalesced with the capital, and became subject to all the limitations imposed by law upon corporate capital.

"Section 115 (h) deals with the taxable status of the stockholder who receives stock dividends, rather than with the liability of the corporation for tax, and to use this provision of the statute in order to ignore the deficit in the case before us, and to deny credit on undistributed profits surtax to this corporation, seems untenable."

Similarly, the Fifth Circuit of Appeals in this case thus concluded:

"If the deficit of this Company had been caused directly by a stock dividend, as the language

of the court in Century Electric Co. vs. Commissioner, supra, indicates the court there thought, we might agree that the Company could not secure the credit by such an act. But the stock dividend here was lawfully accomplished in 1924, twelve years before this surtax on undistributed profits ever existed. Since 1924 this $100,000 has from the corporate standpoint been irrevocably taken out of distributable earnings and profits, or surplus, and has been capital, which could not according to the law recognized in Eisner vs. McComber, supra, and all the authorities, be distributed to shareholders unless on due proceedings to reduce the capital stock. There was then left a substantial surplus. This was lost and the deficit created in the depression years by operating losses. We hold this corporation was entitled to the credit against surtax in the tax years here involved, and the judgment is affirmed."

It is said in the brief for Petitioner that the report of the Senate Committee on Finance on Section 501 of the 1942 Revenue Act is unambiguous and that a reference to it clearly shows that it was never the intent of Congress to construe the section as it has been construed by the two lower courts. Because the law itself is clear, it should be superfluous to examine these reports; but the point is substantially all that Petitioner has to go on, and because of that fact we will undertake to show the unsoundness of the deductions drawn by Petitioner from the report. We do not get from this report the same impression as does Petitioner; and we are certain that it is anything but unambiguous. In fact, it is self-contradictory in that the text reads one way and *one* of the six illustrations given reads the other.

The report on the same section of the Ways and Means Committee of the House uses a different illustration, which is entirely consistent with the wording of the section itself (77th Congress, Second Session, Report No. 3333 accompanying HR 7378, page 170).

Let us first consider the report of the Senate Finance Committee, eliminating that portion which relates to a stock redemption credit and which is, therefore, not relevant to our discussion here. In one paragraph of the text of the report it is said:

> "Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases."

This accords with the meaning of the words used in the law. The Senate Finance Committee illustrated the application of deficit credits by six examples, only one of which (No. 2) is at variance with the meaning of the amendment as we read it. The other five are examples of how the amendment works out when their

natural and common meaning is given to the words of the statute.

It may well be that what the Senate Finance Committee had in mind in making use of example No. 2 was a deficit caused by a prior capitalization of surplus in the course of a nontaxable reorganization which took place subsequent to May 1, 1936, in which case the example will be wholly consistent with the statute. Nothing is said in the example about May 1, 1936; but it is not to be supposed that the Senate Finance Committee deliberately recommended the adoption of this amendment and then illustrated its application by even one out of six examples which is not a logical sequence of the language used in framing the law.

The assumption that example No. 2 in the Senate report referred to a nontaxable reorganization dating subsequent to May 1, 1936 is strengthened by a careful reading of the report of the House Ways and Means Committee. The House report in simple language, like the amendment itself, says that the act "grants relief from the undistributed profits tax for taxable years beginning after December 31, 1935 and prior to January 1, 1938 in certain cases by allowing an additional credit in computing undistributed net income for the portion of the adjusted net income which could not be distributed as a taxable dividend"; and it illustrates the application of the tax by two examples, neither one of which indicates in the slightest that it was the intention that the words of the amendment should be construed in any sense other than their natural, ordinary and common sense. A reading of the two examples given by the Ways and Means Committee of the House shows that that committee at least had in mind granting of relief to corporations which were prohibited by state law or public regulation from paying dividends to the same extent as such relief had

been granted by the 1936 Revenue Act to corporations which were prohibited by a prior written contract from declaring dividends.

The first example used by the House Committee deals with a corporation which by reason of its financial condition is forbidden by state law from declaring a dividend and the second example deals with corporations which without regard to their financial status are forbidden by a written contract to declare dividends. Both are placed in the same category and in each case it is pointed out by the Committee that there would be no liability for any undistributed profits tax.

We have, then a case where the report of the Senate Finance Committee is ambiguous and contradictory unless it be assumed that example No. 2 related to a nontaxable reorganization occurring subsequent to May 1, 1936, while the Ways and Means Committee of the House in its report shows no inconsistency and takes the statute just as it reads and gives the words their ordinary effect in the two examples which it employs.

From this it follows that either a choice must be made between the intention of Congress as set forth in the Senate report and that same intention as set forth in the House report, which would require the Court to take in quite a bit of legislative territory, or the two reports must be reconciled by assuming that example No. 2 given in the Senate report refers to reorganizations subsequent to May 1, 1936 or neither report need be taken into consideration in construing what appears to have been generally accepted as an unambiguous amendment of the revenue laws.

It seems to us that under these circumstances the indicated course is that followed by the courts below, which looked to the act itself and found no difficulty in determining from that source alone what was the intention of Congress in adopting it.

Review of the Argument Made and Statutes and Authorities Cited in Petitioner's Brief.

Such a glittering heap of judicial decisions, Treasury regulations, statutory references and plausible argument is found in the brief for Petitioner that a close examination is justified to separate the gold from the dross and the appearance from the reality. The decisions cited appear to us to mainly fall into three groups. Group A embraces decisions in which dividends were held taxable if declared out of earnings since February 28, 1913.

Since the adoption of Section 115 (a) of the Internal Revenue Code by the Revenue Act of 1936, discussion of this point is academic, for in that section Congress declared that all dividends received which were paid out of earnings of a corporation since February 28, 1913 should be taxable to the recipient. The power of Congress to thus tax dividends has not been questioned and the issue is not in this case. It is interesting to note that prior to 1936 it was generally held in the very decisions which are cited by Petitioner that earnings which *in good faith and for a proper business purpose* were capitalized by means of a stock dividend became capital of the corporation for all purposes, including the application of the Federal income tax laws.

For instance, in *Patty v. Helvering, 98 Fed. (2d) 717*, decided July 18, 1938 by the Circuit Court of Appeals for the Second Circuit, one of the questions here was the issue on which the decision turned.

> "The taxpayer says that stock dividends by impounding the earnings turn them into capital, and make § 115(b) inapplicable: the Commissioner, that they leave earnings unaffected for taxing purposes.";

and this is what Judge Learned Hand, speaking for a unanimous court, said:

> "Congress might have taxed any earnings of a company when they were distributed to the shareholders, whether or not they were in 'liquidation' of outstanding shares. They are income, and the fact that shares have been issued against them and impound them, so as to prevent their distribution, is not material under the Sixteenth Amendment, U. S. C. A. Const. Amend. 16. Nevertheless, the character of a stock dividend for all other purposes then taxation depends upon the local law; substantially upon how far the state of incorporation regards a company's capitalization as an assurance to its creditors; such a dividend takes the earnings out of the control of the company and impounds them until dissolution or cancellation of the shares. To treat the earnings as still earnings is to disregard this, and would indeed postpone liquidation of a company until after its subscribed capital began to be distributed. In the case of old companies, which have saved and invested their earnings, this would often be hard to apply. For example, if their capital had become impaired, and they had used earnings to make up the deficit, it would be a strong doctrine to hold that even these remained taxable; yet there seems to be no less reason for doing so than for denying them the quality of capital when a stock dividend has been issued against them. We do not believe that people regard earnings as maintaining their character in such cases; certainly not when the shares have a par value. Rather, the share increase is thought of as absorbing them just as an original issue absorbed its subscription price; all the capitalized assets are capital regardless of their source. Congress must have used the words of section 115 in this, their usual sense."

Other cases of this type are

Beretta v. Commissioner, 141 Fed. (2d) 452;

Chapman Price Steel Co. v. Commissioner, 146 Fed. (2d) 189;

Commissioner v. Ahlborn, 77 Fed. (2d) 700;

Commissioner v. Champion, 78 Fed. (2d) 513;

Commissioner v. Estate of Bedford 325 U. S. 283;

Commissioner v. Cordingley, 78 Fed. (2d) 118;

Commissioner v. Quackenbos, 78 Fed. (2d) 156;

and others too numerous to be individually reviewed.

The second class of cases is those in which it has been held that a court will look into the legislative history of a doubtful and ambiguous statute and will even attach great importance to a long standing interpretation by the Executive Department of such a statute. This is a doctrine which no one disputes. We do not undertake even to list these cases. They are aptly represented by the decision of this Court in *Edwards v. Douglas, 269 U. S. 204, 70 L. Ed. 235,* in which it was held that,

> "Enquiries into the details of legislative history are sometimes helpful in removing a doubt presented by the language used in a statute."

It may be remarked that in the same case the court declined to resort to that aid because the meaning of the statute was plain from its context and needed no further illumination, as is the case here.

We have not contended that the history of legislative proceedings should not be examined when the words of a statute are doubtful; but we do say that when the words of the statute are clear, as here, and its

meaning plain without such extrinsic aid, the generally approved rule is that the court will look to the statute for its meaning and will apply it as it is written.

The third class of cases is composed of those which when considered in relation to their facts and the questions presented are without relevancy here. Outstanding examples of this type of case are two on which the Petitioner leans heavily, one being the recent decision of this Court in *Commissioner of Internal Revenue v. Estate of Bedford, 325 U. S. 283, 98 L. Ed. 1011*, which held exactly what is stated in paragraph five of the Law Edition syllabus.

> "A sum of money received by a stockholder of a corporation in exchanging old stock for new on a recapitalization is, if paid out of earnings and profits, taxable as income rather than as a capital gain."

In the Bedford case the reorganization took place in 1937; and the essential facts were that the Bedford estate received not only new stock but cash as a result thereof. The court held that the new stock was not taxable as income but that it having been shown that the cash received was cash paid from earnings accumulated since February 28, 1913, it constituted a dividend to the Bedford estate and was taxable as ordinary income. The expressions used by the court in its opinion are applicable to the facts in that case; but the difference between the facts in that case and in the case at bar is so wide that nothing said in the decision can help this Court to decide this particular case.

The same observation is true of the decision in *Commissioner v. Wheeler, 324 U. S. 542, 89 L. Ed. 1166.* That case involved the construction of Section 501 (a) of the Revenue Act of 1940, which deals wholly with

"the gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation." It will be noted that here, as in all other parts of the various revenue acts, whenever Congress wished to make the act applicable to conditions going back to February 28, 1913, it plainly so stated in the act itself.

In the Wheeler case this Court sustained the Commissioner and the tax court as against the court of appeals, and held that the regulation of the Commissioner under which the deficiency was assessed was valid because it corresponded to Section 501 of the second Revenue Act of 1940. Here again the court made statements which have definite relation to the facts in the case before it then but which are not apropos here.

If argument before this Court is to be resolved into a parade on each side of observations and statements made by the court in cases where the facts and issues were dissimilar, the exposition might be interesting but it seems to us it would be of very little value to the court.

It is said in the brief for Petitioner that the phrase "earnings and profits" has a long history in the Federal statutes and that it is no longer open to doubt that the term has a special meaning in the Federal tax sense. An examination of the congressional statutes will show that the term "earnings and profits" was uniformly used by Congress in the income tax statutes in the same sense that ordinary people would give to the words in ordinary commercial affairs. Whenever Congress has intended that "earnings and profits" should mean earnings and profits since February 28, 1913 or has intended that it should mean anything other than the natural and ordinary sense of the words used, it will be found that Congress has expressly so said.

At the top of page 12 of the brief for Petitioner appears reference to Sections 26 (c) (2), (e) and (f), 27 (f), 102 (a), 112 (c) (2), 115 (a), (b), (c), (e), (g), (h) and 351 of the Revenue Act of 1936, which sections are referred to as examples of the use by Congress of the term "earnings and profits" in a special tax sense. Similarly, it is said that the phrase "deficit in accumulated earnings and profits" is used in Section 27 (a) (3) of the Revenue Act of 1938.

We have read each of the sections of the two revenue acts referred to except Section 351 of the Revenue Act of 1936, which we did not find in the act; and the conclusion is irresistible that Congress did not use these terms in any special sense but used them in exactly the same sense in which they were understood by the taxpayer and by the two courts below. It is further clear that any departure from the ordinary and common meaning of the words when so intended by Congress is specifically set forth in the taxing statutes. For example, Section 26 (c) (2) of the Revenue Act of 1936 refers twice to earnings and profits, and both times the words are given their ordinary and natural meaning. The same thing is true of Section 26 (f), Section 27, Section 102 (a), Section 115 (c), (e), and Section 115 (h).

Let us now look at the other sections which are referred to in Petitioner's brief and see if in every instance where Congress referred to "accumulated earnings and profits" and meant profits and earnings accumulated since February 28, 1913 it did not expressly say so.

In Section 27 (f) of the 1936 act the reference is to "the earnings or profits accumulated after February 28, 1913". In Section 112 (c) (2) certain gains were taxed as dividends in an amount "not in excess of his ratable share of the undistributed earnings and profits

of the corporation accumulated after February 28, 1913". In Section 115 (a) dividends are defined as distributions made "(1) Out of its earnings or profits accumulated after February 28, 1913, or (2) out of earnings or profits of the taxable year." In Section 115 (g) it was provided that "to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913 shall be treated as a taxable dividend."

We think that the theory that language was used in a special tax sense by Congress in referring to earnings and profits or deficit in accumulated earnings and profits lacks factual basis. These terms have been frequently employed by Congress in revenue acts and they are employed with equal frequency by businessmen, lawyers, economists, accountants, bookkeepers, storekeepers and practically everyone else who either operates a business or is interested in the result of such operation. It is not necessary to give the congressional use of these terms any specialized tax meaning in order for them to be read and understood by lawyer or layman; and we submit that there is no occasion here for interpreting them in any way other than as did the court of appeals in its outstandingly able opinion.

There are many other arguments made in the brief for Petitioner which we should like to discuss; but this brief is already too long and we therefore turn immediately to our last point, which concerns the force and effect of the Treasury regulations.

This is not a case where Congress has given to the Commissioner any power to change, alter or affect the character of the relief which it has extended to the corporations caught between the Federal mandate to distribute profits on the one hand and the state prohibition against such distribution on the other. If the

meaning of the law were doubtful—if the terms used were ambiguous and hard to understand, an occasion would be presented for a reasonable interpretation by the Petitioner which might be approved by this Court; but those elements are not present in this situation. We deem it unnecessary to cite authorities to sustain our contention that a regulation of the Petitioner which conflicts with the congressional enactment is void.

It is respectfully submitted that the judgment of the court of appeals is correct and should be affirmed.

Respectfully submitted.

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APPENDIX

Report of the Committee on Finance, United States Senate, 77th Congress, Second Session, on Section 501 of the Revenue Bill of 1942:

"Section 501. Additional Credits For Undistributed Profits Tax.

"This section is the same as in the House bill, except that a new paragraph to section 26 (c) has been added, providing for an additional credit in cases of corporations having a deficit in accumulated earnings and profits and prohibited by law from paying dividends, and except that a new subsection has been added providing for a stock redemption credit.

"Section 501 amends section 14 (a) (2) of the Revenue Act of 1936, relating to the definition of undistributed net income, and section 26 of that act, relating to credits of corporations, and grants relief from the undistributed-profits tax for taxable years beginning December 31, 1935, and prior to January 1, 1938, by allowing as an additional credit in computing undistributed net income the portion of the adjusted net income which, in certain instances, could not be distributed as a taxable dividend. Relief is also granted in the situation where, for example, the Y corporation in February, 1936, sold stock upon condition that the proceeds of the sale be used to retire certain preferred stock, and could not secure any deduction for the amount so used in computing its undistributed-profits tax. To the extent that the amounts paid may have been a dividend under section 27 (f) of the Revenue Act of 1936, no credit could be allowed since the distribution was a preferential dividend under section 27 (g) of that act. The sale and retirement were consummated prior to the President's message of March 3,

1936, to Congress which was the first suggestion of an indistributed-profits tax applicable to the year 1936. After the enactment of the undistributed-profits tax the corporation did not have sufficient assets remaining which could be used to make distributions so as to prevent the application of such tax.

"Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases.

"Also under section 14 of the Revenue Act of 1936, it was possible that the undistributed net income of a corporation might exceed accumulated and current earnings and profits. In such case the tax could not be avoided even if distributions were made to shareholders. This result was primarily due to the fact that section 117 (d) of the Revenue Act of 1936 limited capital losses to $2,000 and section 27 (a) and (b) operated to disallow any credit where a distribution did not constitute a taxable dividend. Section 115 of the act provided that the term 'dividend' means a distribution from

earnings or profits, either those accumulated after February 28, 1913, or those realized during the current taxable year. The purpose of the undistributed profits tax was to force the payment of taxable dividends. Where a corporation has no earnings or profits, it cannot make a taxable distribution which would constitute a dividend allowable as a dividends-paid credit in computing the undistributed net income subject to the surtax.

"The application of the deficit credits provided by these amendments may be illustrated by the following examples:

"(1) The X corporation for the calendar year 1936 had an adjusted net income of $200,000 but had a deficit in accumulated earnings and profits as of the close of the preceding calendar year of $20,000. By reason of a State law in effect prior to May 1, 1936, with respect to deficit corporations, only $180,000 of this adjusted net income could be distributed as dividends. Under section 14 of the Revenue Act of 1936, X corporation would be subject to undistributed-profits surtax on $20,000 even though it paid out the entire amount which it could have distributed without violating the State law—namely, $180,000, as taxable dividends. Under the amendment to section 26 (c), X corporation would be allowed a credit of $20,000, and would not be liable for any undistributed-profits tax for the calendar year 1936.

"(2) Assume in the above example that the deficit in accumulated earnings and profits is $20,000 for income tax purposes, but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization

amounts to $250,000. In this case, although the State law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income.

"(3) If in the example (1) above there was in addition to the deficit of $20,000, a contract prohibiting the payment of dividends in excess of $150,000, under the existing paragraph (1) of Section 26 (c) the corporation would be entitled to a credit of $50,000, that being the amount of adjusted net income in excess of the net income which may be distributed without violating the contract. Since the credit of $50,000 allowable under paragraph (1) is greater than the credit of $20,000 allowable under paragraph (3) in the section as amended, the former credit is the one to be used as provided in amended paragraph (4).

"(4) The X corporation for the calendar year 1936 had a gross income of $300,000, miscellaneous deductions of $98,000, and capital losses of $100,000, but only $2,000 of the capital losses were deductible due to the provisions of section 117 (d) of the Revenue Act of 1936. Its adjusted net income was therefore $200,000 ($300,000 less $98,000 less $2,000) while its earnings or profits were $102,000 ($300,000 less $98,000 less $100,000). Assuming that the X corporation had no accumulated earnings or profits as of the beginning of the calendar year 1936 and in 1936 paid the entire amount it could distribute as taxable dividends, namely, $102,000, its undistributed net income subject to tax under section 14 of the Revenue Act

of 1936 would be $98,000. Under subsection (f) of this amendment the X corporation would be allowed an additional credit of $98,000, the amount by which the adjusted net income of $200,000 exceeded the earnings and profits of the taxable year of $102,000, and would not be liable for any undistributed profits tax for the calendar year 1936.

"(5) If in the above example there was a contract in existance prior to May 1, 1936, under which the X corporation could not distribute dividends in excess of $150,000 during the calendar year 1936, section 26 (c) (1) of the Revenue Act of 1936 is applicable and allows a credit of $98,000, namely, an amount equal to the excess of the adjusted net income, $200,000, over the aggregate of the amounts which can be distributed within the taxable year as dividends, $102,000. Accordingly, the new deficit credit is unnecessary in such a case, as the X corporation would not be liable to any undistributed-profits tax for the year 1936 under existing law.

"(6) Assume in example (4) that X corporation had a deficit of $20,000 in accumulated earnings and profits as of the close of the calendar year 1935, and the State law prohibited dividend distributions during the existence of a deficit in accumulated earnings and profits. X corporation distributed only $82,000 as taxable dividends, that being the total amount which was available for distribution by reason of the capital losses and the prohibition of the State law. In addition to the deficit credit of $98,000 provided in this amendment by subsection (f), paragraph (3) of section 26 (c) of this amendment provides a credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year or, in this case, $20,000.

Thus corporation X by distributing as taxable dividends the sum of $82,000 would be relieved from payment of undistributed-profits surtax.

"The section contains a provision permitting the refund or credit with interest of any overpayment for the taxable years involved to the extent resulting from the application of the section, if claim is filed within 1 year from the date of enactment of this act. Such refund or credit is to be made notwithstanding the fact that some other provision of law or rule of law (other than compromise)—for example, statute of limitation, closing agreement, board decision, or rule of res judicata, etc.— would, on the date of enactment of this act, or within 1 year from such date, prevent such refund or credit."

* * * * *

Report of the Committee on Ways and Means of the House of Representatives of the United States, 77th Congress, Second Session, on Section 501 of the Revenue Bill of 1942:

"Section 501. Additional Credit for Undistributed Profits Tax.

"This section amends section 14 (a) (2) of the Revenue Act of 1936, relating to the definition of undistributed net income, and section 26 of that act, relating to credits of corporations, and grants relief from the undistributed profits tax for taxable years beginning after December 31, 1935, and prior to January 1, 1938, in certain cases by allowing an additional credit in computing undistributed net income for the portion of the adjusted net income which could not be distributed as a taxable dividend.

"Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax

at various rates from 7 to 27 percent of their undistributed net income, even though such income was in excess of accumulated and current earnings or profits. In such a case the tax could not be avoided even if distributions were made to shareholders. This result was primarily due to the fact that section 117 (d) of the Revenue Act of 1936 limited capital losses to $2,000 and section 27 (a) and (h) operated to disallow any credit where a distribution did not constitute a taxable dividend. Section 115 of the act provided that the term 'dividend' means a distribution from earnings or profits either those accumulated after February 28, 1913, or those realized during the current taxable year. The purpose of the undistributed profits tax was to force the payment of taxable dividends. Where a corporation has no earnings or profits, it cannot make a taxable distribution which would constitute a dividend allowable as a dividend credit in computing the undistributed net income subject to the surtax.

"The application of the deficit credit provided by this amendment may be illustrated by the following examples:

"(1) The X corporation for the calendar year 1936 had a gross income of $300,000, miscellaneous deductions of $98,000, and capital losses of $100,000, but only $2,000 of the capital losses were deductible due to the provisions of section 117 (d) of the Revenue Act of 1936. Its adjusted net income was therefore $200,000 ($300,00 less $98,000 less $2,000) while its earnings or profits were $102,000 ($300,000 less $98,000 less $100,000). Assuming that the X corporation had no accumulated earnings or profits as of the beginning of the calendar year 1936 and in 1936 paid the entire amount it could

distribute as taxable dividends, namely, $102,000, its undistributed net income subject to tax under section 14 of the Revenue Act of 1936 would be $98,000. Under this amendment the X corporation would be allowed an additional credit of $98,000, the amount by which the adjusted net income of $200,000 exceeded the earnings and profits of the taxable year of $102,000, and would not be liable for any undistributed profits tax for the calendar year 1936.

"(2) If in the above example there was a contract in existence prior to May 1, 1936, under which the X corporation could not distribute dividends in excess of $150,000 during the calendar year 1936, section 26 (c) (1) of the Revenue Act of 1936 is applicable and allows a credit of $98,000, namely, an amount equal to the excess of the adjusted net income, $200,000, over the aggregate of the amounts which can be distributed within the taxable year as dividends, $102,000. Accordingly, the new deficit credit is unnecessary in such a case, as the X corporation would not be liable to any undistributed profits tax for the year 1936 under existing law.

"The section contains a provision permitting the refund or credit with interest of any overpayment for the taxable years involved to the extent resulting from the application of the section, if claim is filed within 1 year from the date of enactment of the bill. Such refund or credit is to be made notwithstanding the fact that some other provision of law or rule of law (other than compromises), e.g., statute of limitations, closing agreement, Board decision, or rule of res judicata, etc., would, on the date of enactment of the bill, or within 1 year from such date, prevent such refund or credit.